

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE ALLEGED)	CASE NO.
DEFICIENCIES OF VERNA HILLS, LTD.)	9881

O R D E R

The Commission initiated this proceeding to allow Verna Hills, Ltd. ("Verna Hills"), an opportunity to show cause why it should not be penalized for failing to correct the service deficiencies noted in a Commission Utility Inspection Report dated February 27, 1987. An evidentiary hearing was held on April 14, 1987 and Verna Hills submitted testimony regarding its efforts to correct the service deficiencies. The Utility and Rate Intervention Division of the Office of the Attorney General ("AG") intervened and participated in the hearing.

On April 6, 1988, the Commission ordered that all of the Verna Hills Reinspection Reports prepared by the Commission's Engineering Division subsequent to February 27, 1987 should be incorporated into the record of this proceeding and the parties were granted an opportunity to file written comments and/or request a further hearing. Comments were received from Verna Hills and the AG, but neither party requested a further hearing.

Over the past few years the Commission has received numerous service complaints from customers of Verna Hills. The Commission's Inspection Reports indicate that the sewage treatment

facilities have suffered from inadequate operation and maintenance for an extended period of time. Lack of adequate financial resources appears to have been a major problem confronting Verna Hills and this led to its voluntary filing in March 1984 for reorganization under Chapter 11 of the Bankruptcy Code.

Verna Hills' plan for reorganization included the filing with the Commission of a request for increased rates. By Order entered May 9, 1986 in Case No. 9484, Application of Verna Hills, Ltd., for an Emergency and Permanent Rate Increase, the Commission authorized both an increase in the monthly service rate plus two limited term monthly surcharges. The service rate was designed to produce sufficient revenues to allow Verna Hills to operate and maintain its system on a continuing basis. One surcharge was designed to produce, over a 3-year period, sufficient revenues to allow Verna Hills to recover from its customers a portion of its past-due accounts payable. The other surcharge was designed to produce, over a 4-year period, sufficient revenues to permit Verna Hills to perform the needed repairs and plant improvements listed in an appendix to that rate Order.

The Commission recognized in Case No. 9484 that since the total cost for the plant improvements exceeded \$40,000, Verna Hills would be financially unable to perform the improvements on a timely basis absent a surcharge. The Commission expressly directed Verna Hills to "immediately attempt to make necessary financial arrangements with a lending institution (or the firm

completing the renovation)"¹ utilizing the monthly surcharge as security for the financing.

At the hearing in this investigation, the owner and president of Verna Hills, Don Bates, testified regarding his efforts to obtain financing to perform the necessary plant improvements. He stated that he contacted two banks shortly after the new rates were approved, but neither was willing to loan any funds until Verna Hills established a sufficient cash flow. Consequently he said he decided to wait 6 months until taking any further steps. However, as of the date of the hearing, almost 1 year had elapsed and no further steps had been taken to obtain financing. In January 1987 he began pumping sludge from the lagoon, but that activity was suspended due to his failure to obtain the proper permits from the Natural Resources and Environmental Protection Cabinet. As of the date of the hearing, the permits had been obtained and the lagoon pumping was projected to be completed within 120 days. Mr. Bates further testified that he was awaiting all the necessary environmental permits prior to obtaining bank financing and that he expected to secure a loan within 30 days.

The Verna Hills Reinspection Reports since the hearing indicate that little progress has been made in pumping the lagoon or performing the repairs that were to be covered by the surcharge. In response to these Reinspection Reports, Verna Hills filed comments on April 20, 1988. Verna Hills claims that since

¹ Case No. 9484 Order dated May 9, 1986, page 12.

the surcharge was to be collected over 4 years, it should have 4 years to complete the needed repairs. Furthermore, Verna Hills claims that although the Commission's rate Order in Case No. 9484 discussed external financing, Verna Hills was not obligated to obtain such financing and none had been obtained. The comments also note that the Commission has taken no action on Verna Hills' request of July 31, 1987 to extend the surcharge for the repairs for an additional 9 months to pay interest on a loan. The AG has filed comments stating that it strenuously objects to any extension of the surcharge due to Verna Hills' failure to comply with prior Commission Orders to make plant improvements and to limit expenses, particularly for salaries.

Based on the evidence of record and being advised, the Commission is of the opinion and hereby finds that there is no merit to Verna Hills' claim that it has 4 years to complete the repairs ordered in Case No. 9484. The 4-year surcharge was established in that case solely to provide security for bank or contractor financing. The repairs ordered in Case No. 9484 were essential to bring the treatment plant into compliance with the Commission's sewer service regulations. Verna Hills is still not in compliance with those regulations and compliance cannot be attained until the repairs are completed. Verna Hills cannot be permitted to remain in violation of Commission regulations for 4 years.

Mr. Bates has failed to make a good faith effort to obtain the requisite financing. His request to extend the surcharge for 9 months is not to facilitate bank or contractor financing but

to proceed with a loan from an affiliated company owned by Mr. Bates. The evidence demonstrates that such a transaction on a less than arms-length basis is not in the public interest. Despite the Commission's Order in Case No. 9484 restricting the level of management fees to be paid by Verna Hills to \$1800 per year, Mr. Bates has ignored that Order and paid himself in excess of \$6,000 per year. These amounts should have been spent on operating and maintaining the treatment plant.

The Commission will not tolerate Verna Hills' failure to perform the necessary repairs as listed in the Order in Case No. 9484 and as cited in the February 27, 1987 Utility Inspection Report. The existing conditions at the treatment plant violate the Commission's service regulations, 807 KAR 5:071, Section 7(1). As set forth in the March 23, 1988 Utility Inspection Report, a substantial portion of the necessary repairs is still not completed. Despite the passage of 2 years since the final Order in Case No. 9484, half of the sludge remains to be pumped from the lagoon and no work has begun on a majority of the repairs to the treatment plant. The Commission further finds that Verna Hills has failed to demonstrate the existence of any valid reason why the service deficiencies have not been corrected.

Therefore, the Commission finds that a penalty, pursuant to KRS 278.990(1), is justified under the circumstances of this case. Taking into account the length of time that Verna Hills has had to correct the noted deficiencies and the potentially serious health hazard posed by its existing condition, the Commission will impose a fine of \$500.

Spencer H. Williams
Commissioner